Impact of sustainability on relative returns

Casper Hesp |Achmea Real Estate | ODV Zomer Klantevent 2024 | 4 June 2024

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Real Estate

Making homes more sustainable is a big issue in the Netherlands

Bijna alle huiseigenaren kunnen verduurzaming woning financieren

De Jonge versoepelt huurplafond voor nieuwbouw en verduurzaming

Nog meer regels op de woningmarkt?

Meer hypotheek voor zuinige woning

Essent waarschuwt voor hoge kosten voor huishoudens die niet verduurzamen

Our study

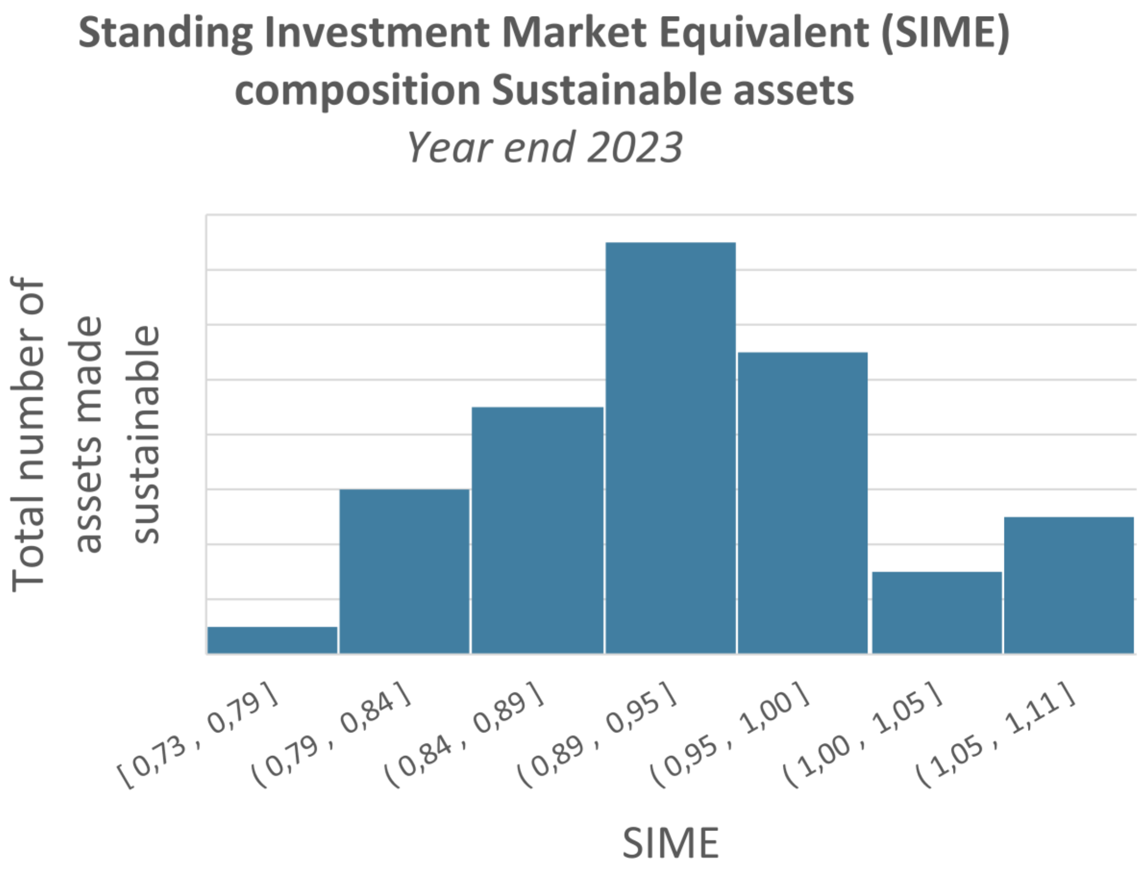
- We will all have to deal with it: making our real estate more sustainable
- Substantial challenge for the Netherlands
- This is an important issue for investors in Dutch residential property
- More clarity needed – are sustainability investments reflected in returns?
- Study done by Maarten van der Spek (PhD in the field of private real estate)

Methodology

- For private equity, the public market equivalent (PME) is used, which discounts private cash flows using public market yields
- This is also possible for real estate: you can invest every euro in an existing building or market instead of implementing sustainability
- It is important to compare each investment with an alternative that is as similar as possible (a relevant benchmark for each asset)
- This is called the SIME (Standing Investment Market Equivalent)
- ***A SIME of 1 indicates that the return of the asset and the market are equal***
- ***A SIME of 1.2 indicates that the asset has made 20% more return than the relevant market***
- ***A SIME of 0.8 indicates that the asset has made 20% less return than the relevant market***

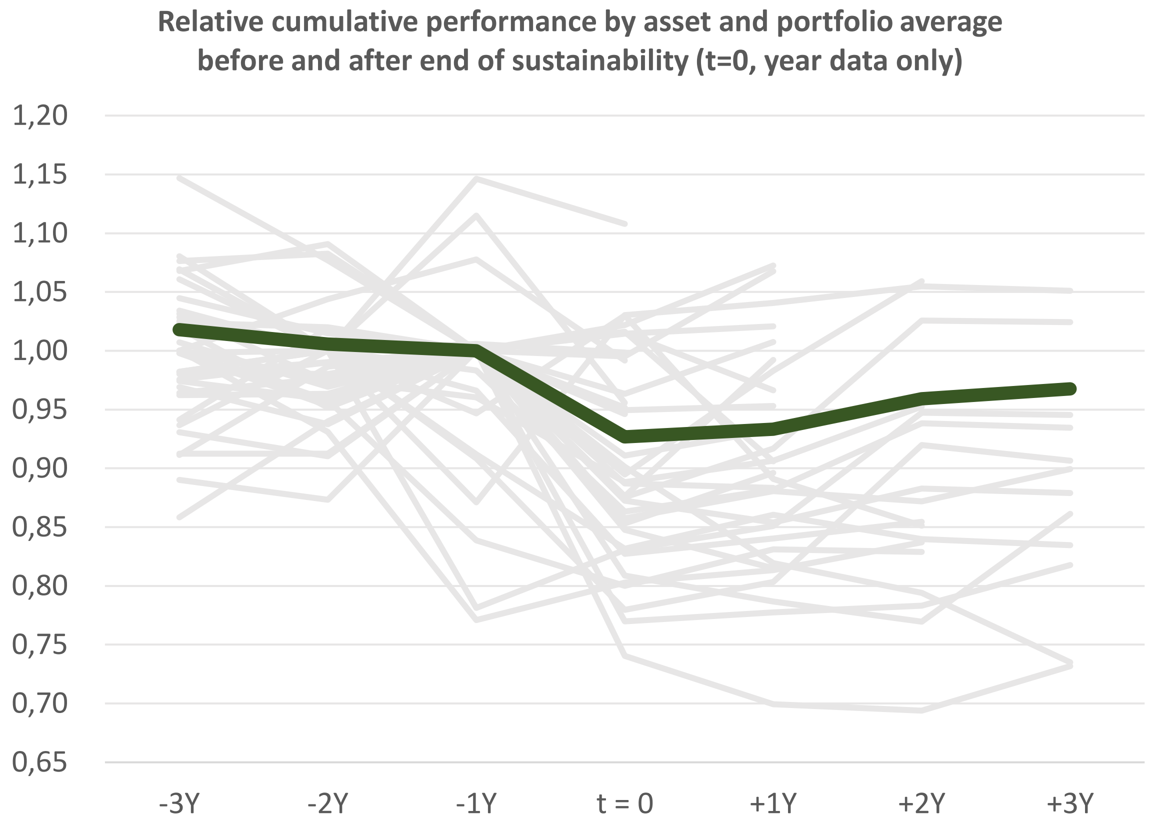
Only 16% of assets have a SIME above 1

- The average SIME at the end of 2023 is 0.93...
- ... which means that on a cumulative basis, the assets made more sustainable have returned 7% less than the relevant benchmark
- 16% of assets have a SIME of above 1
- 32% of assets underperform by 11% or more



After the end of sustainability investment, recovery follows

- Not every asset is sustainable in 1 year
- It is therefore important to organise the assets after the sustainability investments have been made
- T = 0 indicates when sustainability investments are complete
- The results show that relative performance recovers when sustainability investments are completed



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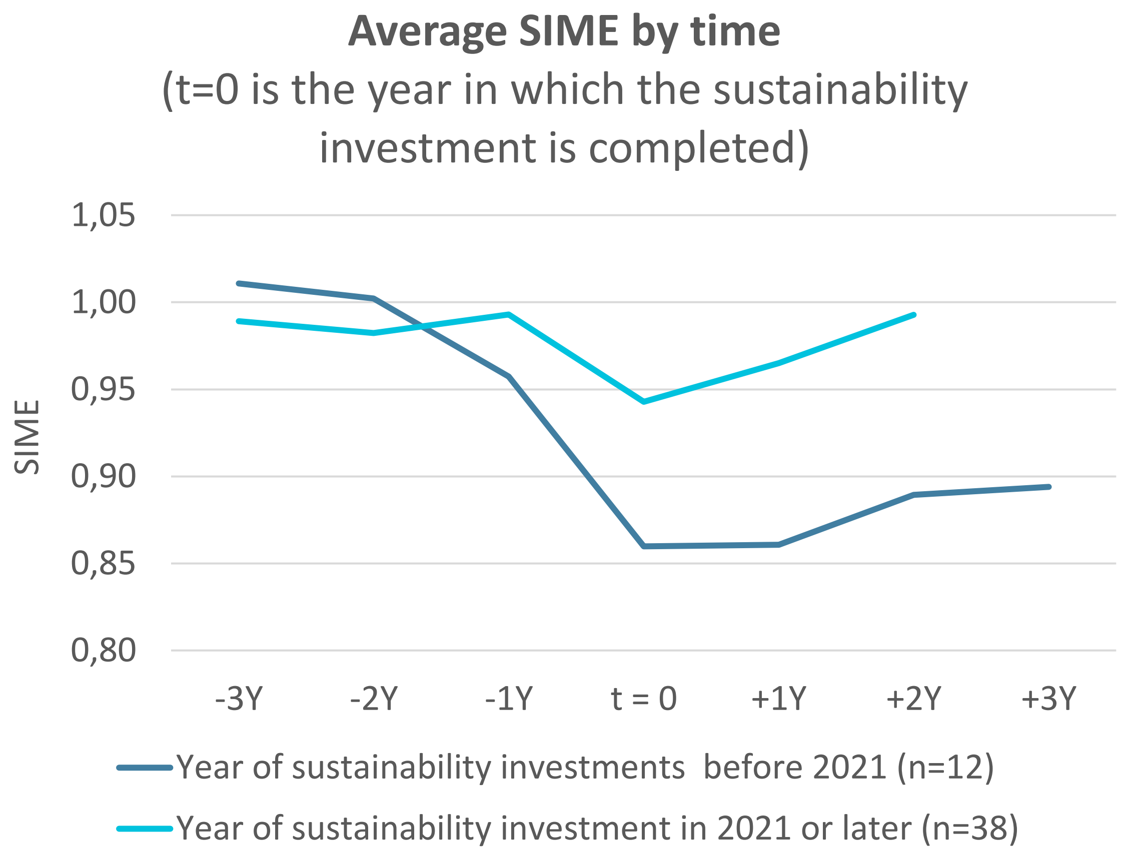
Almost full recovery of sustainable investments after two year

- If a benchmark segmented by age and type (EGW / MGW) is used...
- ... then the results improve slightly
- The average SIME is 0.95
- Thus, the age/type correction has a positive relative effect of around 2%.
- As in the other analyses, the trend is positive only years after the completion of the sustainability investments
- ***<u>Of particular note is the almost complete correction for newer sustainability projects</u>***



Conclusion: Sustainability cost relative returns, but recovery is visible

- Making real estate more sustainable is necessary to meet sustainability goals

- However, it appears that valuers are not yet fully reflecting this in their valuations.

- Research based on all preserved assets in the Achmea Real Estate portfolio reveals the following:
  - On average, all sustainable assets underperform their relevant regional benchmark by 7%, but by 'only' 5% when adjusted for age and property type
  - Once sustainability is complete, these assets outperform their benchmark on average
  - Sustainability projects from 2021 onwards appear to have less negative impact...
  - ...and even almost fully corrected in the years following the completion of the sustainability investments (if corrected for age)

- This analysis will need to be updated in the coming years to fully understand the financial impact of making buildings more sustainable

Achmea Real Estate

The financial value of sustainability

Looking ahead with ARE’s Residential Impact Fund |Ruud van Maanen | ODV Zomer Klantevent 2024

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Impact investing with real estate

Impact investing

Investing with the intention to generate a positive impact on one or more social and/or environmental themes alongside financial returns, based on measurable objectives, without significantly compromising other social and environmental factors.

Impact with real estate

Physical sustainability

Taking action on climate change by reducing CO_2 emissions and promoting biodiversity

Social impact

Creating a lasting impact with satisfied tenants, affordable housing, and suitable accommodation for the elderly and key professions

Sustainable results

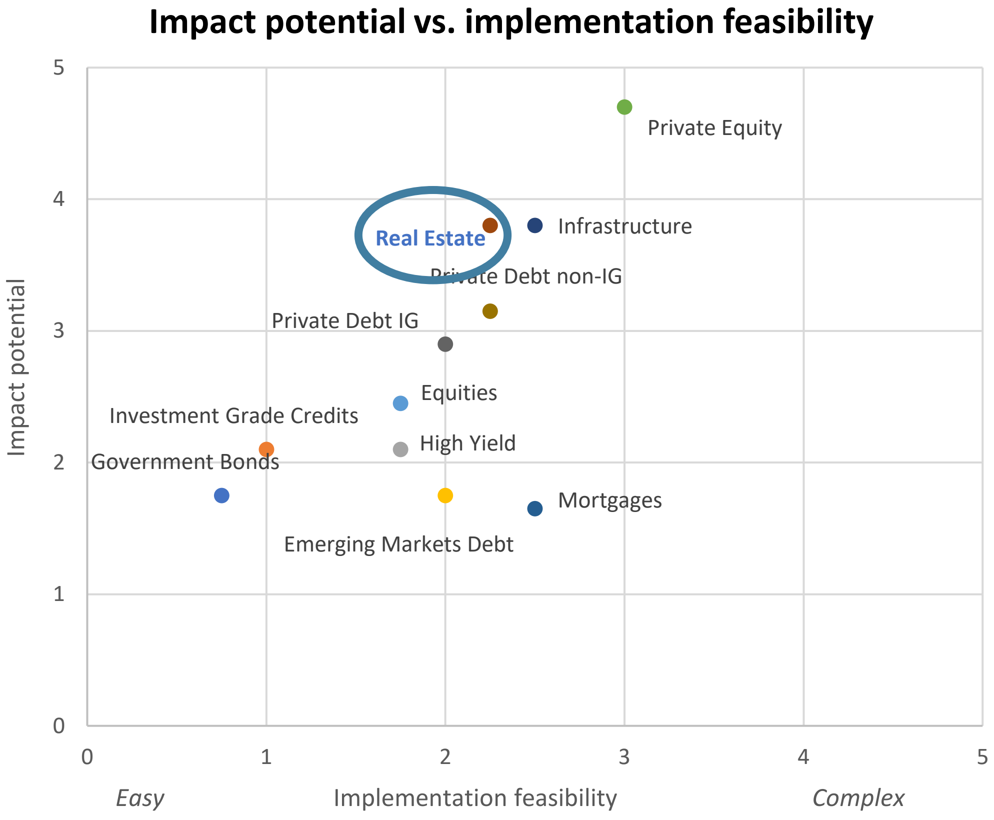
Delivering sustainable results for investors by striving to outperform ESG benchmarks, fostering sustainable partnerships with suppliers, and ensuring good corporate governance

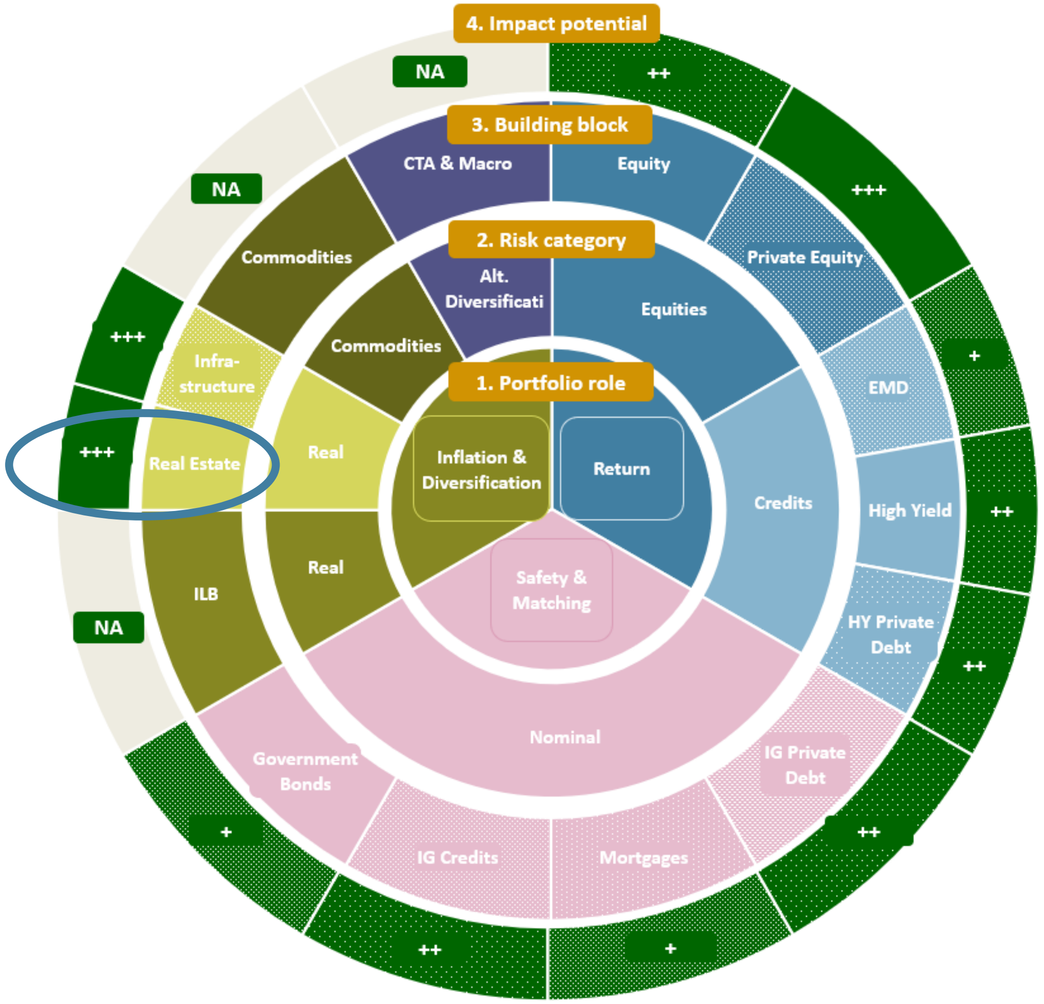
We opt for investments in real estate with high societal value and appropriate financial returns. In doing so, we work for our institutional clients (and their clients) to secure a good income for now, in the future within a sustainable, appealing living environment.

Source: Achmea Real Estate ESG-strategy 2023 - 2030

Categories assessed based on both impact and portfolio role

Weighing impact potential and implementation feasibility



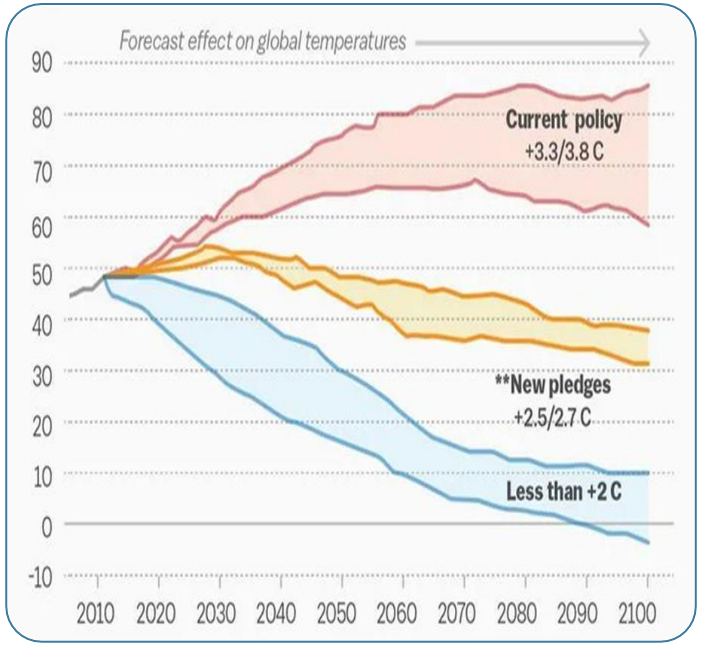


Source: Achmea Investment Management

Acceleration is necessary to achieve the Paris climate agreement goals by 2050

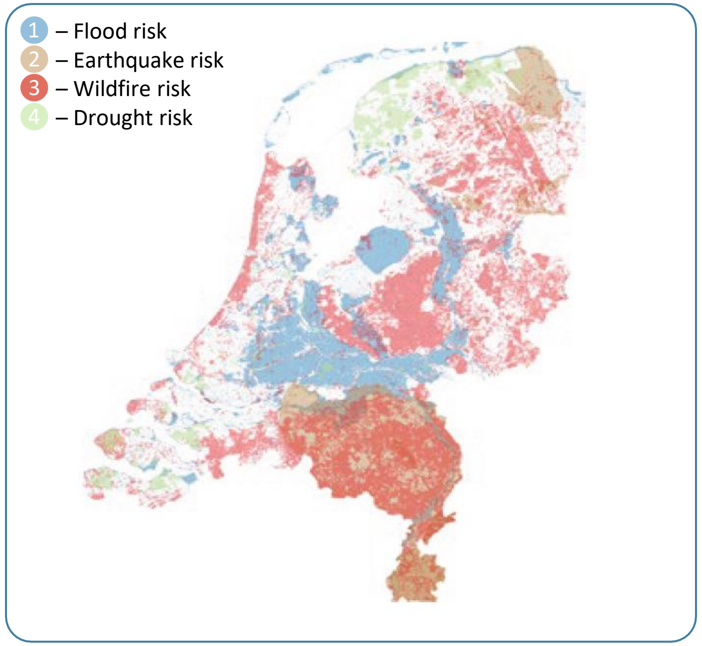
Paris climate agreement: keeping global average temperatures from rising 2°C

Beyond 2°C, we risk dramatically higher sea levels, changes in weather patterns, food and water crises



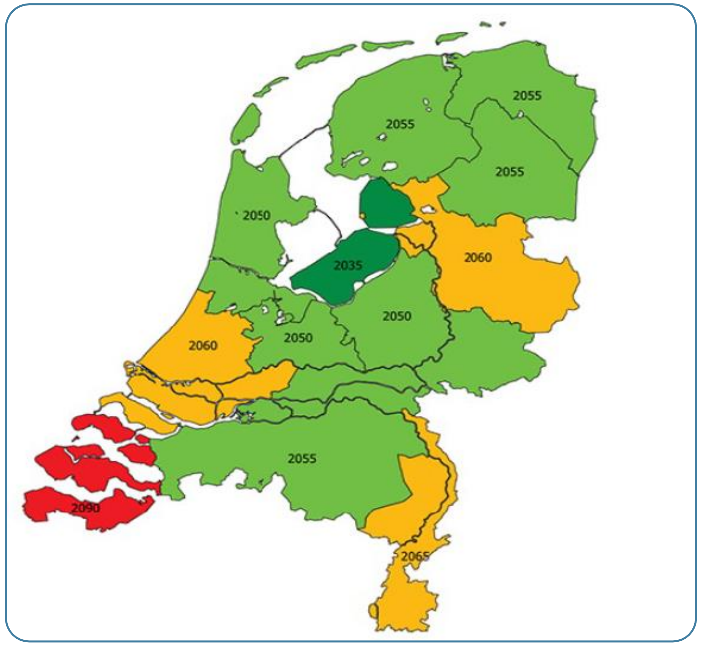
Source: Voxx - 4 things to know about the Paris climate agreement

More than 5 million houses are exposed to climate risk. And that number is increasing



Source: Calcasa, Klimaatatlas

At current rate, upgrading the housing market towards Label A will take at least until 2055



Source: Calcasa 2021 Q1 WOX kwartaalbericht

*One of the goals of the Paris Climate Agreement is the reduction of the energy consumption of the built environment by two-thirds by 2050.

Transforming existing residential stock is crucial to meet climate goals

~85% of the residential stock of 2050 has already been built and does not meet required energy standards

-95% (2050) -55% (2030)	38%	30%	Dutch government recognises urgency
Net reduction of greenhouse gas emissions in Europe required to reach climate goals	Of CO_2 emissions in the Netherlands comes from the built environment, the majority is energy consumption[1)]	Of homes in the Netherlands have an energy label D or lower[2)]	**2024** New legislation allows for additional rent increases for better energy labels **2030** Minimum energy label D required to rent out house

1) *Source: Dutch Green Building Council*
2) *Source: RVO*

Sufficient upgrading potential in the existing residential stock in the Netherlands

From label D to A requires € ~35bn, saves 0.9Mton CO_2 yearly; D to Paris Proof € 68bn and saves 2.1Mton

Potential number of rental units to be upgraded in the Dutch housing market

	Private rent units	**Housing corporations**
Total units	1,100,000	2,300,000
Energy label ≤D (%)	40%	23%
Units to be upgraded	440,000	530,000
Total units to be upgraded	**970,000**	

Source: RVO, Capital Value, RHDHV, ABF Research

Impact investing by making existing residential housing future proof

Improve homes from energy label D and lower to label A, while keeping them affordable for tenants

Primary Impact theme: Climate

Reduce the impact of climate change by executing the energy transition

… aims to realise affordable and clean energy access, reducing greenhouse gas (GHG) emissions and improving the overall energy efficiency of the residential portfolio, by investing in energy-efficient technologies such as solar panels, energy-efficient appliances, and insulation.

…reduces energy consumption and associated GHG emissions. The fund will support climate action by investing in energy-efficient renovations, promoting renewable energy integration, and fostering sustainable housing practices.

Secondary Impact theme: Social

Improve the living environment in an affordable manner for tenants

… contributes to creating sustainable cities and communities by improving the quality of housing, enhancing liveability and promoting urban regeneration in an affordable manner, by upgrading and renovating buildings to meet sustainability standards.

Source: https://www.achmearealestate.nl/-/media/achmearealestate/documenten/esg/strategie/esg-strategie-2023-2030.pdf

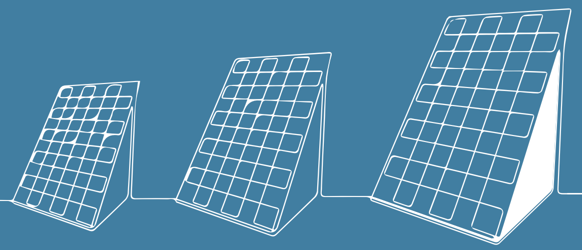
Additionality: positively impacting by combatting climate change

Futureproofing existing residential stock

RIF focuses primarily on **reducing climate change** by lowering CO_2-emissions while keeping living costs affordable.

It invests in the **upgrade of the existing residential stock** in the Netherlands and upgrades the energy performance to **maximise the sustainability impact within a suitable financial return target**.

While contributing to the energy transition and providing a comfortable living environment.



Roadmap towards impact and financial return

- Sustainability upgrade on acquired assets with label D or worse
- Increase value of assets and increase rental income
- Decrease cost of living for tenants
- Target IRR: 5-7% (gross and unlevered) and create ESG impact

Enabling the way to CRREM 1.5°C and become Paris Proof

Stepped approach of the energy transition

Paris Proof

Renewable energy

Label A

Improving building shell

≥ Label D

Type of upgrade[2)]

Single family homes: € 480/m²
Multi family homes: € 405/m²

1)

Single family homes: € 435/m²
Multi family homes: € 425/m²

Single family homes: € 915/m²
Multi family homes: € 830/m²

PARIS PROOF DGBC CRREM

- 4-10 solar panels
- Heat pump
- Electric cooking
- Ventilation
- Heat recovery system
- Door insulation

- Façade and cavity wall insulation
- Floor and roof insulation
- Glass replacement

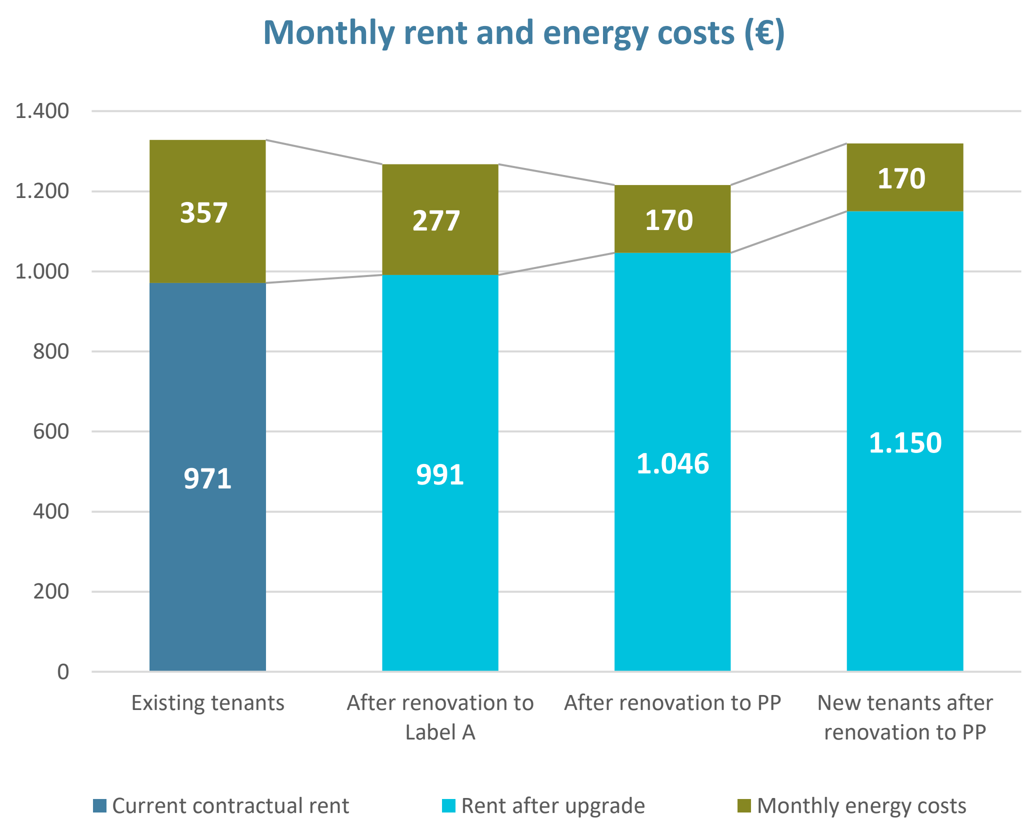
1) This concerns representative energy consumption. To achieve an energy label, it is advisable to fill any potential gap by means of solar panels.
2) The measures mentioned are indicative and may differ per package and situation.
Source: Royal HaskoningDHV

Improve living environment whilst aiming to decrease overall housing expenses

Tenant benefits from home upgrades from EPC D to Paris Proof

- Existing tenants profit from upgrade of homes from EPC label D to Paris Proof as the example shows:
  - Increased living comfort in a modernized home
  - Improved building condition
  - Limited rent increase
  - Monthly energy savings higher than rental increase

- New tenants moving in after the upgrade will benefit from the upgraded home:
  - Investments largely covered by rent increase
  - Rent increases below energy savings, resulting in lower total costs of living and improved affordability



Source: RHDHV, ARE

Our base case scenario projects unlevered IRRs between 5% and 7%

First decisive factor is the "brown discount" taken into account at acquisition

	Base case	Worst case	Best case
Indexation			
Acquisition and development costs	2.5%	4.0%	1.5%
Contract rent	2.5%	2.0%	3.5%
Market rental value	3.0%	2.0%	4.0%
Property value	3.0%	2.0%	4.5%
Investment in sustainability per unit			
EPC Label A	€ 50,000	€ 60,000	€ 40,000
Paris Proof	€ 100,000	€ 120,000	€ 80,000
Monthly rent increase			
MRV EPC Label A	€ 110	€ 55	€ 170
MRV EPC Paris Proof	€ 179	€ 100	€ 275
CR EPC Label A	€ 20	€ 10	€ 40
CR EPC Paris Proof	€ 75	€ 40	€ 150
Purchase price metrics			
Value per unit	€ 210,000	€ 210,000	€ 210,000
Price per unit	€ 177,000	€ 189,000	€ 147,000
Brown discount	16.0%	10.0%	30.0%
GIY	6.6%	6.2%	8.0%

	Base case	Worst case	Best case
Label A			
Capex adj GIY on RI	5.3%	4.7%	6.5%
Capex adj GIY on MRV	5.7%	5.0%	7.3%
Implied Gross Exit Yield	5.3%	4.8%	5.8%
Paris Proof			
Capex adj GIY on RI	4.5%	3.9%	5.9%
Capex adj GIY on MRV	5.0%	4.2%	6.6%
Implied Gross Exit Yield	5.0%	4.5%	5.6%
IRR Label A			
Gross IRR	6.7%	3.5%	10.9%
Net IRR	6.1%	2.9%	10.3%
IRR Paris Proof			
Gross IRR	5.0%	2.2%	9.8%
Net IRR	4.5%	1.6%	9.1%

Source: Achmea Real Estate estimates

Let’s create impact together and be the change

Why you should invest RIF

Create impact

Create a positive impact on climate change by transitioning the existing housing stock while benefitting from a suitable financial opportunity

Benefit from our expertise & skills

We have in-depth knowledge, skills and experience on the residential market as well as measuring and reporting on impact to make this unique investment opportunity a success

Take the next step

- Express your interest
- Co-create in finetuning fund characteristics
- Participate in the opportunity

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